

Service Date: October 4, 1994

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Joint Application)	UTILITY DIVISION
of GTE NORTHWEST INCORPORATED and)	
CITIZENS TELECOMMUNICATIONS COMPANY)	DOCKET NO. 93.7.30
OF MONTANA for Approval of the Transfer)	
of the Eureka, Libby and Troy Exchanges.)	ORDER NO. 5731c

IN THE MATTER Of the Complaint of)	
Robert E. Todd and 58 Petitioners,)	
)	
Complainants,)	DOCKET NO. 94.1.9
)	
-vs-)	
)	(Docket remains open
GTE NORTHWEST INCORPORATED and)	for monitoring -to be
CITIZENS TELECOMMUNICATIONS COMPANY)	closed at a later
date.)	
OF MONTANA,)	
)	
Defendants.)	

FINAL ORDER APPROVING THE TRANSFER
OF THE EUREKA, LIBBY AND TROY EXCHANGES
FROM GTE NORTHWEST INCORPORATED TO
CITIZENS TELECOMMUNICATIONS COMPANY OF MONTANA
AND SATISFACTION OF THE TODD COMPLAINT

APPEARANCES

FOR THE APPLICANT GTE-NORTHWEST INCORPORATED:

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**FOR THE APPLICANT CITIZENS TELECOMMUNICATIONS
OF MONTANA:**

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FOR THE MONTANA CONSUMER COUNSEL:

Mary Wright, Esq., 34 West Sixth Avenue, Helena, Montana 59601

FOR THE COMMISSION:

Eric N. Eck, Chief Revenue Requirements Bureau
Chuck Evilsizer, Staff Attorney

BEFORE:

Bob Rowe, Vice Chairman
Dave Fisher, Commissioner
Nancy McCaffree, Commissioner

FINDINGS OF FACT

BACKGROUND

1. On July 16, 1993, GTE Northwest Incorporated (GTE-NW) and Citizens Telecommunications Company of Montana (Citizens Tel) filed with the Montana Public Service Commission (Commission) an application seeking approval for the sale by GTE-NW to Citizens Tel of all of its Montana telephone operations which consist of three exchanges: Eureka, Libby and Troy. The three exchanges contain 7,263 access lines. Applicants submit that approval of the purchase of these telephone properties is in the public interest. Citizens Tel is a wholly owned

subsidiary of Citizens Utilities. In the application Citizens and Citizens Tel state that they are financially sound utility companies dedicated to providing customers the highest quality service at reasonable cost. Citizens Tel will operate its telephone properties in accordance with all rules and orders issued by the Montana Public Service Commission and will adopt and provide service pursuant to the tariffs for GTE-NW in effect at the time of closing.

2. On July 30, 1993, the Commission issued a Notice of Joint Application for Approval of Transfer and Intervention Deadline. The deadline for intervention in Docket No. 93.7.30 was August 25, 1993.

3. On July 29, 1993, the Commission issued Order No. 5731 which was a Protective Order.

4. On August 30, 1993, the Commission issued Order No. 5731a which was a Procedural Order. That order established a hearing date of January 11, 1994.

5. On August 31, 1993, the Montana Consumer Counsel (MCC) filed a Protest to the Montana Telephone Cooperatives Petition to Intervene.

6. On September 1, 1993, the Commission issued a Notice of Staff Action which granted intervention to the following parties:

Montana Consumer Counsel
Northwestern Telephone Systems, Inc.
MCI Telecommunications Corporation
Montana Telephone Cooperatives
Interbel Telephone Cooperative

7. On September 1, 1993, the Commission received a late-filed request for intervention from AT&T.

8. On September 8, 1993, the Montana Telephone Cooperatives filed a response to the Protest of the Montana Consumer Counsel to the Montana Telephone Cooperatives Petition to Intervene.

9. On September 10, 1993, the Commission issued a Notice of Commission Action which granted AT&T's request for late intervention.

10. On September 21, 1993, the Commission issued a Notice of Commission Action which reset several dates including the date prefiled testimony was due from GTE-NW and Citizens Tel. The remaining dates of the procedural schedule were suspended.

11. On October 5, 1993, Citizens Tel and GTE-NW filed direct testimony in Docket No. 93.7.30. The witnesses for Citizens Tel were Robert S. Crum and Mark T. Shine. The witnesses for GTE-NW were Timothy J. McCallion and John P. Blanchard.

12. On October 8, 1993, the Commission issued a Notice of Commission Action which granted the protest filed by the Montana Consumer Counsel to the intervention of the Montana Telephone Cooperatives. The Cooperatives were dismissed as general intervenors but were granted status as *amicus curiae*.

13. On November 23, 1993, the Commission issued Order No. 5731b which contained amendments to the procedural schedule and Procedural Order No. 5731a. That order set the hearing date for March 29, 1994.

14. On December 23, 1993, MCC filed the testimony of Mr. Allen G. Buckalew. No other intervenor filed testimony in Docket No. 93.7.30.

15. On January 31, 1994, the Commission received a Petition from Robert E. Todd. Mr. Todd is a GTE-NW customer living in Troy. The Petition signed by 58 people requested that their multi-party service be upgraded to single party service at a reasonable cost. This Petition was assigned Docket No. 94.1.9 and was consolidated with Docket No. 93.7.30 for hearing purposes.

16. On February 22, 1994, GTE-NW filed the rebuttal testimony of Walt Sorg and Ryan Gaddy. GTE-NW indicated that it intended at the hearing, to have Mr. Sorg adopt and sponsor the direct testimony originally filed by Timothy J. McCallion and to have Mr. Gaddy adopt and sponsor the direct testimony originally filed by John P. Blanchard.

17. On February 25, 1994, the Commission issued a Notice of Public Hearing.

18. On March 23, 1994, the Commission issued an Order to Show Cause to GTE-NW and Citizens Tel to appear before the Commission and show cause why the following described information designated as proprietary should not be publicly disclosed and released from proprietary protection:

1. The total purchase price proposed to be paid by to GTE-NW by Citizens Tel for the three local exchanges (Eureka, Libby and Troy).
2. The depreciated book value of each of the exchanges proposed to be sold, and the total thereof; and all other information and calculations used to determine said book values.
3. The accumulated depreciation reserve of each of the exchanges proposed to be sold, and the totals thereof, and all other information and calculations used to determine the net book values.

4. The amount of Federal and State taxes GTE-NW estimates will be paid on the sale of exchanges (for each exchange and the total), and all other information and calculations to determine said taxes.

5. The net gain on the sale, before taxes, and after taxes, and all data, information and calculations used to determine said values.

6. All other data, information and calculations used to determine the sales price, and the components thereof, including all transaction costs (by exchange and totals), which has been submitted as proprietary information in this Docket.

A hearing on the Order to Show Cause was set for April 13, 1994, at 9:00 a.m. at the Commission offices in Helena.

19. On March 23, 1994, the Commission received a Joint Motion to Reschedule the hearing in Docket Nos. 93.7.30 and 94.1.9. The Motion filed by

GTE-NW and Citizens Tel requested that the hearing be rescheduled to dates approximately forty-five days later. The reason for the request was so that the Joint Applicants could respond to recent developments in regard to network upgrades that were the subject of the complaint in Docket No. 94.1.9.

20. On March 24, 1994, MCC filed comments on the Joint Applicants= Motion to reschedule the hearing. MCC noted that witness Allen G. Buckalew opposed the sale as proposed by the Joint Applicants, but stated that the sale could be structured to benefit all parties. His proposal was that the Commission order a sharing of the gain requiring GTE-NW to upgrade facilities and service in its service territory (or put funds in escrow for that purpose) and credit the ratepayers with the cost. MCC was prepared to proceed with the hearings as scheduled and litigate the proper amount and disposition

of the gain on the sale as well as the public interest issue. If, as a result of the proposed forty-five day delay, the Joint Applicants could present an acceptable plan and commitment to upgrade the facilities and service, and an acceptable proposal on disposition of the gain, then it might be possible to conclude this case by stipulation. Given that possibility, MCC did not oppose the Joint Motion to delay the hearings.

21. On March 24, 1994, the Commission issued a Notice of Commission Action which indicated that the hearing in these Dockets would be rescheduled for dates approximately 45 days from March 24.

22. On March 28, 1994, the Commission issued an amended Notice of Hearing. That Notice rescheduled the hearing on its Order to Show Cause to April 19, 1994, at 9:00 a.m.

23. On April 14, 1994, GTE-NW filed a Motion for a Continuance. In the Motion, GTE-NW stated that the Company would not contend the material referenced in the Order to Show Cause was proprietary based on the particular facts surrounding this case and the treatment given this type of information by the Commission to other utilities. GTE-NW and Citizens Tel were discussing system upgrade and service improvements to address concerns raised by customer petitions.

24. On April 19, 1994, a hearing was held on the Commission's Order to Show Cause. At that hearing GTE-NW indicated that the Company no longer contended that the information described in the Order to Show Cause was proprietary. On the same day, GTE-NW filed a

letter which confirmed that the information would no longer be proprietary.

25. On June 27, 1994, the Commission issued a Notice of Public Hearing. That Notice indicated that there would be a hearing in Troy on July 18, 1994, at 7:00 p.m. to consider the Todd complaint. It set the technical hearing in Docket No. 93.7.30 at 9:00 a.m. beginning on July 19, 1994, in Libby with an evening meeting at 7:00 p.m. that night. Finally, a third evening meeting was set for July 20, 1994, in Eureka at 7:00 p.m.

26. On July 12, 1994, GTE-NW filed a letter with the Commission which indicated that Ryan Gaddy (who was supposed to adopt the direct testimony of John P. Blanchard) would be replaced at the hearing by Barry Johnson.

27. On July 14, 1994, Citizens Tel filed a letter with the Commission which indicated that Aloa Stevens would be adopting the direct testimony of Robert Crum at the hearing. In addition, Robert O'Brien would adopt the direct testimony of Mark Shine.

28. On July 18-20, 1994, hearings were held in Troy, Libby and Eureka pursuant to the Commission's Notice of Hearing of June 27, 1994.

29. On July 26, 1994, the Commission issued a Notice of Staff Action which established the briefing schedule in Docket No. 93.7.30:

August 22, 1994:	Briefs due from GTE-NW and Citizens Tel.
September 7, 1994:	Briefs due from all other parties.
September 26, 1994:	Reply briefs due from GTE-NW and Citizens Tel.

The briefing schedule was later suspended by staff action.

30. On August 22, 1994, the Commission received a stipulation of the sale docket signed by GTE-NW, Citizens Tel and the Montana Consumer Counsel. A copy of the stipulation is appended to this Order as Attachment A.

31. The stipulation provides that after the closure of the sale, Citizens Tel will construct and install facilities in the exchanges sufficient to provide single party service to all customers and will convert the central offices in the Eureka and Libby exchanges to digital technology. During the first construction season after the closing of the sale, Citizens Tel will accomplish outside plant upgrades in the Troy exchange and upgrade all multi-party customers to single party service in that exchange. All other central office and outside plant improvements will be made as expeditiously as possible within three years from the closing of the transaction. As central offices are converted to digital switching and multi-party service is eliminated in each exchange, Citizens Tel will eliminate recurring mileage charges. There will be no nonrecurring service charges to customers for these upgrades.

32. It is estimated by Citizens Tel that the cost of these upgrades on a total state basis will be \$5.85 million. The stipulation provides that the original cost of the intrastate portion of the network upgrades shall be deemed to be \$2.5 million less than the actual cost. This amount will be specifically applied as capital contributed to the outside plant construction portion of the upgrade project, and will be amortized consistent with the depreciation of such plant. In rate cases, the unamortized amount will be used to

reduce Citizens Tel=s rate base. Based upon the estimated cost of the modernization program the Montana intrastate rate base will increase by \$1.361 million calculated as follows:

Total State Plant Cost	\$5.85
X Intrastate Separation	<u>.66</u>
Intrastate Plant Cost	\$3.861
Less: Capital Contributed	<u>\$2.5</u>
Net Intrastate Rate Base	\$1.361

Commission Decision

33. This is a case which began when GTE-NW and Citizens Tel filed a Joint Application for a transfer of GTE-NW's three Montana exchanges (Eureka, Libby and Troy). After the testimony of the applicants and MCC was filed, the Commission received the Todd complaint which requested the elimination of multi-party service at reasonable rates. During the public hearings on these matters, the Commission learned that the level of service in these exchanges was simply not meeting the expectations of the consuming public. Over and over public witnesses described their frustration with the level of service being provided. The level of dissatisfaction has convinced the Commission that action to improve service in these exchanges is necessary. There are two courses of action which are open to the Commission at this time to improve service in these exchanges. The first is to reject the stipulation, and order GTE-NW to improve service in these exchanges. However, there are serious concerns with proceeding down that path. First, if the agreement were rejected, the capital contribution of \$2.5 million would vanish. Second, based on the record compiled in Docket No. 93.7.30, it is very unclear when the

modernization would take place if left to GTE-NW according to GTE-NW=s testimony.

34. Given those concerns, the Commission turns to the stipulation presented by the parties. While the stipulation does not satisfy the Commission in every detail, it does address all of the major concerns which the Commission heard expressed at the public hearings. The modernization plan will result in the deployment of digital switching in these exchanges. That is consistent with the Commission=s view that analog switches no longer have the capability to provide reasonable service. Multi-party service was the biggest frustration expressed by witnesses at the public hearings. The agreement ensures that multi-party service, which is not appropriate in today=s environment, will be eliminated. Mileage charges, were also opposed by customers, and have been a barrier to single party service in these exchanges. Mileage charges will be eliminated. On balance, the Commission finds that the stipulation represents an agreement which will dramatically improve the level of service for the customers in Eureka, Libby and Troy. Based on the concerns of the public, the Commission approves the stipulation as being in the public interest.

In approving the stipulation, the Commission notes that Citizens Tel has agreed to complete the modernization within three years of the close of the sale. The Commission strongly encourages Citizens Tel to complete the upgrade of the switches in Eureka and Libby within one year after the close of the sale and to complete the outside plant upgrades in all exchanges within two years of the close

of the sale. Three years is too long to wait for service improvements.

35. The Commission observes that the local GTE-NW employees who will now work for Citizens Tel received many positive comments from customers during the hearings. As a result of the modernization program, both Citizens Tel and its local employees will have the opportunity to demonstrate excellent service to the customers. The future holds many opportunities and challenges. It is up to Citizens Tel to provide state of the art telecommunications services and facilities. The Commission advises Citizens Tel to listen closely to its Montana customers to determine their needs and respond promptly.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the sale and transfer of utility assets in Montana.

2. The Joint Applicants GTE-NW and Citizens Tel, provide or will provide telephone service for consumers in the State of Montana, and are "public utilities" under regulatory jurisdiction of the Montana Public Service Commission.
Section 69-3-101, MCA.

3. The Montana Public Service Commission has provided adequate public notice of all proceedings, and an opportunity to be heard to all interested parties in these Dockets. Section 69-3-104, MCA, and Title 2, Chapter 4, MCA.

ORDER

1. The Commission approves the sale and transfer of the Eureka, Libby and Troy exchanges from GTE-NW to Citizens Tel pursuant to the stipulation signed by GTE-NW, Citizens Tel and MCC.

2. Within three years of the close of the sale, Citizens Tel will convert the switches in Eureka and Libby to digital switches, and eliminate multi-party service. As multi-party service is eliminated, mileage charges will be eliminated. As noted above in Finding of Fact No. 34, the Commission expects the modernization to proceed on a faster schedule.

3. In the first construction season after the close of the sale, Citizens Tel shall eliminate multi-party service in the Troy exchange.

4. This Order approves a stipulation which addresses the issues raised in the Todd complaint which was assigned Docket No. 94.1.9. The Commission will leave Docket No. 94.1.9 open to monitor progress on the provision of single party service in the Troy exchange.

5. The original cost of the intrastate portion on these network upgrades will be reduced by \$2.5 million, which is a capital contribution. No depreciation shall be taken on the capital contribution. The capital contribution will be amortized consistent with the depreciation of the associated plant in service. In future rate cases the unamortized amount of the capital contribution will be used to reduce Citizens Tel=s intrastate rate base.

6. Citizens Tel will adopt the rate base, depreciation rates, tariffs and contracts in effect for GTE-NW at the time of the closing.

Citizens Tel should file compliance tariffs at least four weeks prior to the closing date.

7. This Order is issued only for the specific facts of this record. It does not constitute precedent for any future case.

8. Citizens Tel is to file quarterly reports with this Commission on the status of the modernization program. The reports should detail all work completed, as well as the cost of that work, any changes to the estimated cost of the program, the work to be performed in the next quarter, and the expected completion date of the program. Detailed work papers should be supplied with the report which support the costs incurred. Also, the quarterly reports should detail all customer complaints and contacts with customers concerning significant service issues.

9. The Commission will be considering extended area service issues in Docket No. 94.2.5. See "EAS Notice," Docket No. 94.2.5, February 11, 1994. The Troy-Libby route is specifically listed on Attachment A of the EAS Notice. The Commission will be considering the possible elimination of toll charges for many areas of the state in that Docket. In addition to the Troy-Libby route, Eureka-Troy and Eureka-Libby may also be considered. In addition to its involvement in Docket No. 94.2.5, Citizens Tel is directed to address the status of extended local calling in its first general rate case filed after the closing of the sale.

10. During the transition from GTE-NW to Citizens Tel, special care must be taken to ensure that customers are not plagued with billing mistakes. The Commission directs GTE-NW and Citizens Tel to

work together closely to avoid any billing problems during the transition. Care should be taken to have full communication between not only GTE-NW and Citizens Tel, but any other local exchange companies or interexchange carriers who might be affected by the transaction. Careful consideration should also be given to sharing information about the sale with customers on a regular basis during the transition.

11. The Commission shall be notified immediately of the closing of the sale by Citizens Tel.

DONE AND DATED this 27th day of September, 1994, by a 3 to 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ROWE, Vice Chairman
Concurring Opinion Attached

DAVE FISHER, Commissioner

NANCY McCAFFREE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.

OPINION OF COMMISSIONER ROWE

This opinion discusses three issues: 1. The role of public testimony in this case, and the need for ongoing public involvement in the modernization process. 2. The relationship of the stipulation to Lincoln County=s needs, and to the principles I have previously identified as fundamental in cases concerning sale of utility property. 3. The possibility that Citizens Tel might in the future request an "acquisition adjustment," based on the difference between the rate base it is now assuming from GTE and some portion of the purchase price for those assets.

A. The Significance of Public Participation in PSC Proceedings.

I have previously argued that the Commission must avoid erring in either of two directions. On one extreme, the Commission must not simply follow public opinion in making its decisions. On the other extreme, public involvement must be more than lip service or window dressing. To do the former is to abdicate the Commission=s adjudicative authority, as well as its responsibility to act on its expertise in utility regulation and policy. It also creates the possibility that parties to cases will abuse the public participation process by organizing public support for their own position, based on incomplete information.¹

¹I commend all parties to this case for their appropriate approaches to these issues: They provided accurate information to members of the public. They listened to what they heard, and responded thoughtfully.

To do the latter, holding public hearings without seriously considering the testimony, is inconsistent with the constitutional requirement of public participation in government (Montana Constitution, Article II, ' 8). The correct approach is to subject public testimony to the same weighing as other evidence. Public testimony is particularly relevant to issues of service quality, service needs, rate design, and rate impact, and should be weighed along with other relevant evidence. That is what the Commission did in this case.

The public participation process worked exceptionally well in this proceeding. Before the hearing, I distributed to the parties correspondence from members of the public concerning Lincoln County=s needs. This helped shape proposals parties offered in the case. Public testimony received at the hearing was thoughtful, detailed, and well-informed. This testimony had a strong effect on the eventual shape of the stipulation the Commission is now approving. Had the Commission not approved the stipulation, public testimony would have also provided a basis for the Commission to aggressively pursue modernization through other means.²

²It is noteworthy that public testimony was consistent with the hierarchy of telecommunications investment advocated by experts in rural development. The "Aspen Report," E. Parker, Rural America in the Information Age (1989) list ten goals for rural service. In order, they are: 1. Make voice grade service available to all. 2. Make single-party line access to the switched network available to all. 3. Improve quality sufficiently to allow rapid and reliable transmission of data and facsimiles. 4. Provide equal access to long distance carriers. 5. Provide local access to value-added networks. 6. Provide 911 service with automatic number identification. 7. Expand mobile service. 8. Provide touch tone and custom calling services. 9. Provide local voice messaging service. 10. Provide the same services which become generally available in urban areas. The resolution of this case will directly provide for the most important elements on this list, and will lay the foundation for achieving several others.

The sale presents both Lincoln County and Citizens Tel with tremendous opportunities. For these to be realized, public participation will continue to be important. That is why we held informal meetings in Eureka, Troy and Libby after the stipulation was initially approved. That is also why the Order calls for periodic reports on implementation. These will allow both the Commission and members of the public to monitor Citizens Tel=s performance on an ongoing basis.

As a result of public participation in this case, Citizens Tel knows an unusually great deal about its Lincoln County customers and their service needs. It knows many of its customers by name. Citizens Tel has earned respect for its performance to date. Now, it is up to citizens in each community of Lincoln County to hold Citizens Tel accountable, and ensure that the promise of this transaction is realized. Personally, I look forward to working with Lincoln County citizens to ensure this happens.

B. Merits of the Stipulation.

Each of the three telephone exchanges which are a part of the transaction have different primary needs. The challenge was to craft an approach which maximized the benefit for customers in the whole, based on the record in this case.³ The stipulation and order do this.

³Improving the system will benefit not only the individual customers who receive single party

service or access to a digital switch, but will also provide benefits to other customers and to Lincoln County generally, by improving the network of communications between all customers, and laying the foundation for further community development.

Previously, I have stated my conviction that where ratepayers have shouldered the economic burden of utility property and faced the risk of loss on that property, they should be entitled to the gain on the sale of that property. Simultaneously, I recognized the appropriateness of principled compromise, and suggested avenues for reaching settlement.⁴ For purposes of this case, the stipulation we are approving at least minimally meets these conditions. Customers will pay neither depreciation nor interest on \$2.5 million in new plant provided to serve their needs, essentially treating this amount as capital contributed by customers.

The stipulation produces tangible benefits to customers, which, because of the \$2.5 million contribution, could not be achieved by a Commission order. It does so primarily by application of the Federal Communications Commission "separations" process, through which phone company plant and expenses are apportioned between intrastate jurisdictional activities over which state commissions have regulatory authority and interstate nonjurisdictional activities over which states lack authority.⁵ For GTE, 66 percent of its Montana plant and expenses are assigned to intrastate service. As Finding of Fact No. 32 of the order explains, the entire \$2.5 million will be applied to reduce the amount of new investment for which intrastate customers would otherwise be responsible, as follows:

⁴Dissenting opinion in US West Communications Docket No. 93.5.23.

⁵Whether as general policy customers should share only in the intrastate portion of gain was not directly addressed in this case. It should be noted that while interexchange carriers monitored this case, they did not offer testimony.

Total investment in new plant	\$5.85 million
X intrastate separation	<u>.66</u>
Intrastate plant cost	\$3.861 million
Minus Capital Contribution	<u>\$2.5 million</u>
Net intrastate rate base	\$1.361 million

Two and one-half million dollars is approximately half of the net intrastate gain on the sale.⁶ The approximately 7,000 customers would have been much more hard-pressed to pay for these essential improvements had their contribution to the system not been so directly recognized.

C. Acquisition Adjustment.

⁶Net gain of \$7.9 million times 66 percent FCC separation factor equals intrastate net gain of \$5.2 million.

Citizens Tel has asked that it be allowed to request rate treatment of the acquisition adjustment in a future rate case if the Company can demonstrate significant customer benefits which have resulted from the transaction.⁷ The Consumer Counsel opposed this approach. The Commission properly elected not to address the issue: Because an actual request for an acquisition adjustment was not before it, anything the Commission might say in its order would be dictum. However, because the issue is of potential significance both to Citizens Tel and to Lincoln County customers, I personally believe it is worth advising them of the Montana Commission=s policy, and of my own views.

⁷Citizens has carefully avoided saying it "will" request an acquisition adjustment, but has asked that the option not be foreclosed.

It has long been the policy of the Montana Public Service Commission to deny acquisition adjustments. The reason for the policy is easy to understand. Once property is dedicated to utility service, that property enjoys the status of being included in a utility=s rate base. As part of a utility rate base, property earns a return on that investment as well as a return of that investment through the application of depreciation rates. In return for their special status (monopoly power and the opportunity to earn a reasonable rate of return), utilities are required to meet their obligation to serve and to provide reliable service at the lowest reasonable cost. Once property is dedicated to service as utility property, the only value associated with that property that is appropriate for ratemaking is the original cost less depreciation. The original cost concept was established to minimize potential financial wrongdoing, such as increasing property values through resales among subsidiaries of a parent holding company=s organization.⁸ These speculative transactions harm ratepayers.

In the recent U S West Communications Docket No. 93.5.23, where U S West sold 60 of its Montana exchanges to a group of purchasing companies, the purchasing companies paid 1.7 times net book value for the exchanges. In that case the purchasing companies stated that they would never seek recovery of an acquisition adjustment. That decision

⁸James E. Suelflow, The Role of Accounting in Public Utilities, MSU, Michigan, 1973, p. 28.

by the purchasing companies was a key element of the approval of that purchase by this Commission.⁹

During the hearing in this case, Citizens= witness Mr. O=Brien agreed during cross-examination that the State of New York had denied a similar request. In this case, the purchase price represents a multiple of net book value even higher than was paid in the U S West case (2.3 versus 1.7).¹⁰

Approval of the sale in this case rests on the net book value of the GTE-NW rate base. The \$2.5 million customer contribution would be negated by any future acquisition adjustment. If Citizens Tel were to

⁹"The Purchasing Companies have agreed to exclude any and all plant acquisition adjustments for purposes of intrastate and interstate price setting. Presumably, this includes all direct and indirect impacts from payments which exceed the net book values of the 60 exchanges." Declaratory Ruling, p. 5.

¹⁰An argument can be made that in order to discourage speculation, transfers of utility property should never be approved above net book. Such a policy would encourage both purchaser and seller to evaluate transactions based upon which party is best able to operate the property, enhancing overall network efficiency. The policy of not allowing acquisition adjustments serves the same end, forcing the purchaser to ask whether or not it will be able to operate the property as well or better than the seller.

The ratio of purchase price to net book was perhaps less of an issue in this case than in the U S West case because here the Montana transaction is one part of a much larger purchase. If the purchaser is overburdened, it will be because it paid too much overall, not just in Montana.

include an acquisition adjustment in rates, the entire transaction would fail the test of reasonableness.

Citizens Tel would be gravely mistaken to rely on including an acquisition adjustment in rates in this jurisdiction. In my view, the Commission=s policy against that type of ratemaking is clear.

RESPECTFULLY SUBMITTED this 27th day of September, 1994.

BOB ROWE
Vice Chairman